STATE OF CONNECTICUT

DEPARTMENT OF REVENUE SERVICES

OFFICE OF THE
COMMISSIONER

March 15, 2010

TO: The Honorable Eileen Daily, Co-Chair
The Honorable Cameron Staples, Co-Chair
Members of the Finance, Revenue and Bonding Committee

FROM: Richard D. Nicholson, Commissioner RDN
Department of Revenue Services

RE: Senate Bill No. 445, AA Enhancing the Ability of the Department of Revenue Services to Collect Outstanding Taxes.
House Bill No. 5494, AAC Various Changes to Title 12.
Senate Bill No. 430, AAC Certain Cigarette Tax Violations.
Senate Bill No. 444, AAC Revisions to the Nonresident Contractor Bond Statute.

Good morning Senator Daily, Representative Staples and members of the Finance Committee. My name is Richard Nicholson. I am the Commissioner of Revenue Services and I am here before you this morning to urge passage of four bills, all of which were submitted by the Department.

Senate Bill 445, An Act Enhancing the Ability of the Department of Revenue Services to Collect Outstanding Taxes, has several provisions that will help the Department better collect monies currently owed the state. One such initiative is in the form of enabling legislation that will allow the Department to partner with another agency to ensure tax compliance. Under the concept proposed, a license applicant would be required to obtain a clearance from DRS before being allowed to obtain or renew a particular license from another state agency. In other words, a licensee or prospective licensee who has an unsatisfied tax liability and who is not currently in a payment plan will not receive a license until they pay the liability or make arrangements to satisfy the liability. This initiative, which the Department intends to implement as a pilot program and will require the promulgation of regulations, is motivated by licensees using limited liability companies to avoid paying trust taxes, such as sales tax, that they have collected from customers.

Senate Bill 445 also provides that the Department may recoup its collection costs for a civil suit that is brought in the courts of another state when the Department is the prevailing party. Costs would include collection costs and reasonable attorney's fees. This provision is very important in our efforts to pursue delinquent taxpayers who reside outside of Connecticut. Our jurisdiction to use tax warrants to collect tax liabilities is limited to assets in Connecticut. The ability to bring a collection action in another state and include attorneys' fees, solely for out-of-state collections, will put the state on a par with other creditors. Currently 20 percent of our unsatisfied delinquencies are out of state taxpayers. Of our top 100 delinquents, 22 percent are out of state.

Another important collection vehicle that the Department uses is the ability to collect trust taxes, for instance sales taxes or withholding taxes – taxes that are collected for the state and are considered held in trust for the state, from the person responsible for filing those tax returns and paying over the taxes collected. The collection from a responsible person only occurs when the Department is unable to collect the tax from the business entity itself. It is important to emphasize that these taxes have already been collected from the retail customer or the employee – however they have not been paid over to the state. Our revisions to the responsible person statutes will clarify and make uniform the process for collecting from that person. It will provide a hearing for the retailer or employer to contest the liability and, if the liability is sustained, it allows for a second hearing for the responsible person to contest whether that person satisfies the requirements of being a responsible person. It also allows the responsible person to recover from the retailer or employer.

House Bill No. 5494, AAC Various Changes to Title 12, makes changes to several tax statutes. These changes include a new provision addressing the tax avoidance problem associated with entities known as "captive REITS". The problem was highlighted in a front page story in the February 5 2007 edition of the Wall Street Journal, which I have attached for your reference. Essentially "captive REITs" allow a company to pay rent to itself, take a deduction for the rental expenses and receive the rent back through a nontaxable dividend. The circular flow of funds allows a company to save significant corporation taxes by using this scheme.

In discussions with our tax practitioner advisory group, the Department has made some changes to its original proposal, which changes are intended to insure that legitimate "captive REITS" that are employed in foreign markets, nonprofits and publicly traded REITS are not impacted. To this end, I have attached substitute language that embodies the changes that grew out of those discussions and would respectfully request your favorable consideration of these proposed changes.

This bill also revises the procedures for filing amended Connecticut returns in situations where taxpayers file amended Federal income or corporate returns. Currently taxpayers are required to file an amended Connecticut return within 90 days of filing an amended federal return. In the case of amended returns claiming a refund, however, the normal procedure is to wait for the IRS to make a final determination on the refund. Accordingly, and for consistency purposes, the Department has proposed revising the current statutory process so as to require filing an amended return with the Department within 90 days of the final federal determination.

Senate Bill 430, An Act Concerning Certain Cigarette Tax Violations, amends current cigarette tax statutes to make it a $90 infraction instead of a misdemeanor for persons who fail to renew their cigarette dealer's license within 90 days of expiration and to make it a $90 infraction instead of a misdemeanor for anyone who sells, or possesses for sale, less than three cartons of unstamped cigarettes.

Current enforcement of these provisions requires a judicial hearing and generally results in a court ordered fine of approximately $100. In effort to promote judicial economy, the proposed amendments will allow Department law enforcement personnel to issue an infraction, which, if not protested, may be paid through the mail.

Another initiative undertaken by the Department has been to streamline the process involving nonresident contractor bond requirements under Conn. Gen. Stat. §12-430(7). ***Senate Bill 444, An Act Concerning Revisions to the Nonresident Contractor Bond Statute***, is the result of a collaborative effort between the Department and representatives of the private sector. The changes are intended to streamline the process and provide quicker resolution for the contractors involved. The bill provides a mechanism for one bond per project, allows certain compliant nonresident contractors to be treated as resident contractors and provides a $250,000 de minimis amount before a bond is required.

Enclosures

Wal-Mart Cuts Taxes By Paying Rent to Itself

by Jesse Drucker
From The Wall Street Journal Online
February 05, 2007

As the world's biggest retailer, Wal-Mart Stores Inc. pays billions of dollars a year in rent for its stores. Luckily for Wal-Mart, in about 25 states it has been paying most of that rent to itself -- and then deducting that amount from its state taxes.

The strategy is complex, but the bottom line is simple: It has saved Wal-Mart from paying several hundred million dollars in taxes, according to court records and a person familiar with the matter. And Wal-Mart is far from alone.

The arrangement takes advantage of a tax loophole that the federal government plugged decades ago, but which many states have been slower to catch. Here's how it works: One Wal-Mart subsidiary pays the rent to a real-estate investment trust, or REIT, which is entitled to a tax break if it pays its profits out in dividends. The REIT is 99%-owned by another Wal-Mart subsidiary, which receives the REIT's dividends tax-free. And Wal-Mart gets to deduct the rent from state taxes as a business expense, even though the money has stayed within the company.

Partly thanks to sophisticated financial strategies like these, states' tax collections from companies have been plummeting. On average, Wal-Mart has paid only about half of the statutory state tax rates for the past decade, according to Standard & Poor's Compustat, which collects data from SEC filings. The so-called "captive REIT" strategy alone cut Wal-Mart's state taxes by about 20% over one four-year period. Now several state regulators are trying to crack down on the strategy, used largely by retailers and banks, and some other states have changed their laws to try to end the practice. Yesterday, New York Gov. Eliot Spitzer included elimination of the loophole as part of his proposed budget, a fix he said would bring the state $83 million a year.

North Carolina tax authorities are challenging Wal-Mart, saying its REIT strategy was intended to "distort [the company's] true net income," according to its filings in the case in Superior Court in Raleigh, N.C. The state calls captive REITs a "high priority corporate tax sheltering issue" and in 2005 ordered Wal-Mart to pay $33 million for back taxes, interest and penalties stemming from the REIT. The company paid it and last year sued the state for a refund.

The structure Wal-Mart is using features some unusual elements. Because REITs must have at least 100 shareholders to gain tax benefits, roughly 100 Wal-Mart executives were enlisted to own a combined total of around 1% of the REIT's shares, without any voting rights. H. Lee Scott Jr., now Wal-Mart's CEO, was listed as the REIT's "managing trustee" from 1996 to 2004.

A single Wal-Mart real-estate official, Tony Fuller, represented the company both as tenant and landlord in its lease with itself. Ernst & Young LLP, the accounting firm that sold the strategy to Wal-Mart, also is the company's outside auditor. In its internal sales training materials, the accounting firm explicitly labeled the strategy as a method to reduce taxes -- a red flag to tax authorities, who often demand that tax shelters have other business purposes.

Wal-Mart attorneys say in court filings that the strategy is perfectly legal and that North Carolina is exceeding its authority. A spokesman for the Bentonville, Ark., company, John Simley, said Wal-

Mart "is comfortable with its current structure and is in compliance with federal and state tax laws." He added that the REIT structure was adopted to "more effectively and efficiently manage the company's real-estate portfolio, including the impact on the company's overall state tax planning."

Regulators in at least a half-dozen states are going after companies that have trimmed their taxes through similar arrangements, including Regions Financial Corp.'s AmSouth Bancorp. unit; AutoZone Inc. of Memphis, Tenn.; and two units of Bank of America Corp. In a Massachusetts case against Bank of America unit Fleet Funding Inc., authorities call Fleet's REIT arrangement a "sham" in court filings. They note that Fleet increased the salaries of the roughly 100 employees whom it made REIT shareholders to compensate them for personal income taxes stemming from ownership. The Multistate Tax Commission, an association of state revenue authorities, says it has started examining the use of captive REITs to avoid taxes, alerting states to the issue and proposing legislative fixes to close the loophole.

States collected more than $44 billion last year in corporate income taxes, out of $607 billion in total state tax receipts, according to the Nelson A. Rockefeller Institute of Government, a nonpartisan think tank associated with the State University of New York. But the average effective corporate state and local tax rate has dropped from 6.7% during the 1980s to about 5% during the first half of this decade, according to a recent report by the Congressional Research Service. This is in part because of the proliferation of state and local tax breaks, as well as tax shelters, according to several academic and government studies.

Some corporate state tax planners say arrangements like these are merely smart business, and that the loopholes exploited by companies should be fixed by state legislatures rather than litigated by state lawyers. Critics of the shelters complain they let companies use public services provided by local governments -- such as police and fire protection or new highways -- without having to shoulder their fair share of the costs. Meanwhile, the portion of state taxes borne by individuals is steadily rising.

Congress created REITs in 1960 as a way to allow smaller investors to put money in a wide portfolio of commercial real estate, spreading their risk. Congress also gave them a tax benefit: REITs aren't subject to corporate income tax on the profits they pay to shareholders as long as they pay out at least 90% of the profits. The shareholders still usually get federally taxed on the dividends, which still count as income for them.

After a boom in REITs in the early 1990s, big accounting firms including Ernst & Young and KPMG LLP figured out that on the state level, they could pair the tax break on REIT dividends with a separate tax rule that allows companies to receive dividends tax-free from their subsidiaries. With the REIT as a subsidiary itself, two rules aimed at avoiding double taxation could be combined to effectively avoid any taxation at all.

The strategy worked especially well if the REIT was owned by a company incorporated, and claiming to do all its business, in a state such as Delaware or Nevada that often wouldn't tax the corporate income anyway. That created an extra hurdle for other states to challenge the practice if they caught onto it.

Ernst & Young early on targeted the banking industry as a possible beneficiary of the captive REIT strategy. Like retailers, banks have branches in many states and often are liable for lots of state-level corporate tax. Ernst & Young targeted at least 30 banks, some of them its audit clients. The SEC generally permits that dual role as long as the firm's fee isn't contingent on the tax savings.

According to documents from a 1995 internal Ernst & Young sales training meeting reviewed by The Wall Street Journal, the accounting firm suggested banks put some of their income-producing assets, such as a portfolio of mortgages, into a REIT subsidiary, then use the double-tax break to "shelter" the income from state taxes. The REIT would issue a tiny number of non-voting shares to bank "officers and directors" to meet the 100-shareholder rule that REIT law requires.

U.S. banks "pay millions of dollars each year in state and local taxes," read the Ernst & Young presentation to its sales force. "The FSI State Tax Financial Product we have developed can significantly reduce or eliminate this heavy tax obligation..." One section of the Ernst & Young sales package featured hypothetical questions from clients about the REIT shelter, and the proposed answers. To pass legal muster, many corporate tax shelters purport to have additional business purposes behind merely saving taxes. Ernst & Young, however, was blunt about the reason for its proposed strategy:

"Q: What's the business purpose?

"A: Reduction in state and local taxes.

"Q: What if the press gets wind of this and portrays us as a 'tax cheat'?

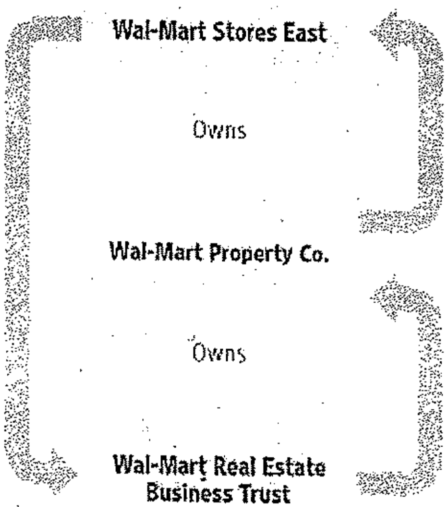
"A: That's a possibility....If you are concerned about possible negative publicity, you can counter it by reinvesting the savings in the community."

An Ernst & Young spokesman declined to comment on its REIT work, saying the firm was "prohibited from commenting on client matters." The spokesman said he could not verify the authenticity of the internal sales training documents based on quotes provided by the Journal. However, he said the "limited language communicated in the internal memo does not reflect the quality and nature of the advice we provide to our clients."

Tax Relief

Wal-Mart has cut its tax bills in about 25 states using a sophisticated real-estate strategy:

Company headquarters in Bentonville, Ark.



Sources: Wal-Mart court filings; WSJ research

State authorities have had mixed records so far in pursuing back taxes and penalties in captive-REIT cases. AutoZone, the big auto-parts chain, won the right to deduct the dividends from its taxes in Kentucky but lost a preliminary round in Louisiana. The Hawaii Department of Taxation won a case involving a REIT used by Central Pacific Financial Corp., a bank holding company. AmSouth is in litigation with Alabama over tax benefits from its REIT.

Fleet Funding's REIT, on which the company was advised by KPMG, has led Massachusetts to seek more than $42 million in back taxes, interest and penalties. BankBoston Corp. is in similar litigation with Massachusetts. Both banks have been acquired by Bank of America, which declined to comment on the litigation.

Fleet's attorneys have said in court papers that its REITs were legitimate, and the fact that they were partly motivated by tax considerations does not legally undermine their valid business purpose -- to raise capital, they say. A KPMG spokeswoman declined to comment on the Fleet case, but said it had stopped any involvement with "prepackaged tax products" before a 2005 agreement it made with the U.S. Justice Department over improper tax strategies that also led to the indictment of 17 former KPMG officials.

It's unknown how many disputes have been raised over the strategy used by Wal-Mart and others, because such tax disputes are generally not disclosed unless lawsuits are publicly filed or the company reveals them in SEC filings.

Wal-Mart adopted its captive-REIT structure just as it was unwinding a previous strategy to reduce taxes that states had begun to challenge. For the first half of the 1990s, the retailer used a so-called intangible holdings company structure also used by many other corporations. Wal-Mart transferred its trademarks to a subsidiary called WMR Inc. in Delaware, which does not tax many forms of corporate income. Then it paid the subsidiary for the use of the brands. That allowed Wal-Mart to deduct those payments from its local income taxes in some states, while WMR's income wasn't taxed by Delaware.

Several states won challenges to the strategy, used by various retailers. Wal-Mart settled a dispute over its use of WMR in Louisiana -- the details of the settlement are sealed -- and lost on the main points of a case in New Mexico. Wal-Mart merged with WMR in February of 1997 and its use as a state tax avoidance vehicle was apparently discontinued, according to New Mexico court records.

In the meantime, Wal-Mart set up a new vehicle to control its state tax bill: captive REITs. In the summer and fall of 1996, Delaware corporate records show, Wal-Mart created a new hierarchy of subsidiaries: a REIT called the Wal-Mart Real Estate Business Trust; a Delaware-based parent company for the REIT, called the Wal-Mart Property Co.; and Wal-Mart Stores East Inc., parent of the Delaware firm. Wal-Mart Property owned 99% of the REIT's shares, and 100% of the voting shares, according to Wal-Mart court filings in North Carolina and West Virginia. The company also set up a similar arrangement for its Sam's Club stores.

To meet the 100-shareholder threshold required for REITs, Wal-Mart distributed a minimal amount of nonvoting stock, to approximately 114 Wal-Mart employees, according to a person familiar with the arrangement. The dividend payouts were nominal. The structure involved Wal-Mart's top executive tier. The shareholders were generally executive vice presidents and above. David Glass, then Wal-Mart's president and CEO, was listed as president of Wal-Mart Stores East on the lease agreement, and Paul Carter, then a Wal-Mart executive vice president, was listed as the president of the REIT.

Wal-Mart began transferring to the REIT ownership of the properties -- the land and buildings -- for hundreds of its stores in 27 states, real-estate records show. Then Wal-Mart Stores East signed a 10-year lease agreement with its REIT that took effect on Jan. 31, 1997, agreeing to pay a fixed percentage of the stores'"gross sales" as rent, according to a copy of the arrangement filed in the North Carolina case. Mr. Fuller, the Wal-Mart real-estate official, is listed as the contact for both the tenant and the landlord. The original lease was due to be renewed this week.

Wal-Mart could deduct from its state-taxable income the rent paid by Wal-Mart Stores East to the REIT. The REIT paid the majority of its rental earnings to its 99% owner, Wal-Mart Property Co., in the form of dividends. That company's base in Delaware gave it another way to avoid liability for state taxes, since some states do require that dividends a REIT pays to its corporate owner be taxed, as the federal government does.

The Delaware subsidiary then paid the money back to Wal-Mart Stores East, the same subsidiary that made the payments to the REIT to begin with. Those payments to Wal-Mart Stores East weren't taxed either, because dividends paid to a corporation by a subsidiary normally aren't counted as taxable income for the parent company.

The result of the circuitous transaction: Wal-Mart could effectively turn rental payments to itself into state level tax-deductions in most of the states where the payments have been made. Under typical circumstances, rent paid to a third-party landlord also would reduce taxable income. But that would ordinarily be cash out the door, like most other tax-deductible expenses. Here, the majority of the tax-deductible rental payments came straight back to Wal-Mart.

The national tax savings have been significant. Over a four-year period, from 1998 to 2001, Wal-Mart and Sam's Club paid company-controlled REITs a total of $7.27 billion that eventually came back to Wal-Mart in states across the country, according to a North Carolina Department of Revenue auditor's report filed in court by Wal-Mart. Based on an average state corporate income tax rate of 6.5%, three accounting experts consulted by The Wall Street Journal estimated the REIT payments led to a state tax savings for Wal-Mart of roughly $350 million over just those four years. SEC filings show the company paid $1.18 billion in state taxes during that period. The loss of federal deductions that bigger state tax payments would have triggered brought the company's effective tax savings overall down to about $230 million. Wal-Mart declined to comment on the figures.

It is not clear how much Wal-Mart has paid to its own REITs in the most recent five years. The yearly rental payments -- on which the tax savings are based -- are pegged to the "gross sales" of the stores, according to the lease agreement.

Underscoring that the rental payments were cashless Wal-Mart accounting moves, an affidavit filed in North Carolina by the company's former controller, James A. Walker Jr., states that the payments were made by simply debiting the account of one subsidiary and then crediting the account of the other. "Wal-Mart Stores, Inc. served, in effect, as a bank for" both sides, the affidavit stated.

In 2005, after an audit, the North Carolina Department of Revenue issued a notice to Wal-Mart challenging the REIT structure. The state is site of about 140 of the company's roughly 3,900 U.S. stores, including Sam's Clubs. Wal-Mart paid the $33 million the state sought, and in March 2006 sued for a refund.

The company argues that the state does not have the authority to essentially combine the results of the subsidiary that did business in North Carolina with those of the Delaware-based unit and the REIT. The Delaware-based subsidiary, the company says, did no business in North Carolina and therefore was not taxable there. The company says in court filings that the REIT was qualified under federal law, that all the deductions were properly taken and that its North Carolina tax returns reflect its "true income."

Substitute language for section 1 of House Bill 5494, AAC Various Changes to Title 12. (Section 1 to be replaced in its entirety.)

Section 1. Subsection (a) of section 12-213 of the general statutes is amended by adding subdivision (27) as follows (*Effective from passage, and applicable to income years commencing on or after January 1, 2010*):

(NEW) (27) (A) Except as provided in subparagraph (B) of this subdivision, "captive real estate investment trust" means a corporation, a trust, or an association (i) that is considered a real estate investment trust for the taxable year under Section 856 of the Internal Revenue Code; (ii) that is not regularly traded on an established securities market; and (iii) in which more that fifty per cent of the: voting power, beneficial interests, or shares, are owned or controlled, directly or constructively, by a single entity that is subject to Subchapter C of Chapter 1 of the Internal Revenue Code.

(B) "Captive real estate investment trust" does not include a corporation, a trust, or an association, in which more than fifty per cent of the entity's voting power, beneficial interests, or shares are owned by a single entity described in subparagraph (A)(iii) of this subdivision that is owned or controlled, directly or constructively, by (i) a corporation, a trust, or an association that is considered a real estate investment trust under Section 856 of the Internal Revenue Code; (ii) a person exempt from taxation under Section 501 of the Internal Revenue Code; (iii) a listed property trust or other foreign real estate investment trust that is organized in a country that has a tax treaty with the Untied States Treasury Department governing the tax treatment of these trusts; or (iv) a real estate investment trust that is intended to become regularly traded on an established securities market, and that satisfies the requirements of Section 856(a)(5) and Section 856(a)(6) of the Internal Revenue Code under Section 856(h) of the Internal Revenue Code.

(C) For purposes of this subdivision, the constructive ownership rules of Section 318 of the Internal Revenue Code, as modified by Section 856(d)(5) of the Internal Revenue Code, apply to the determination of the ownership of stock, assets, or net profits of any person.

Sec. 2. Subdivision (1) of subsection (a) of section 12-217 of the general statutes is repealed and the following is substituted in lieu thereof (*Effective from passage, and applicable to income years commencing on or after January 1, 2010*)

(a) (1) In arriving at net income as defined in section 12-213, whether or not the taxpayer is taxable under the federal corporation net income tax, there shall be deducted from gross income, (A) all items deductible under the Internal

Revenue Code effective and in force on the last day of the income year except (i) any taxes imposed under the provisions of this chapter which are paid or accrued in the income year and in the income year commencing January 1, 1989, and thereafter, any taxes in any state of the United States or any political subdivision of such state, or the District of Columbia, imposed on or measured by the income or profits of a corporation which are paid or accrued in the income year, (ii) deductions for depreciation, which shall be allowed as provided in subsection (b) of this section, [and] (iii) deductions for qualified domestic production activities income, as provided in Section 199 of the Internal Revenue Code, <u>and (iv) in the case of any captive real estate investment trust, the deduction for dividends paid provided under Section 857(b)(2) of the Internal Revenue Code,</u> and (B) additionally, in the case of a regulated investment company, the sum of (i) the exempt-interest dividends, as defined in the Internal Revenue Code, and (ii) expenses, bond premium, and interest related to tax-exempt income that are disallowed as deductions under the Internal Revenue Code, and (C) in the case of a taxpayer maintaining an international banking facility as defined in the laws of the United States or the regulations of the Board of Governors of the Federal Reserve System, as either may be amended from time to time, the gross income attributable to the international banking facility, provided, no expense or loss attributable to the international banking facility shall be a deduction under any provision of this section, and (D) additionally, in the case of all taxpayers, all dividends as defined in the Internal Revenue Code effective and in force on the last day of the income year not otherwise deducted from gross income, including dividends received from a DISC or former DISC as defined in Section 992 of the Internal Revenue Code and dividends deemed to have been distributed by a DISC or former DISC as provided in Section 995 of said Internal Revenue Code, other than thirty per cent of dividends received from a domestic corporation in which the taxpayer owns less than twenty per cent of the total voting power and value of the stock of such corporation, and (E) additionally, in the case of all taxpayers, the value of any capital gain realized from the sale of any land, or interest in land, to the state, any political subdivision of the state, or to any nonprofit land conservation organization where such land is to be permanently preserved as protected open space or to a water company, as defined in section 25-32a, where such land is to be permanently preserved as protected open space or as Class I or Class II water company land.

Sec. 3. Subdivision (3) of subsection (a) of section 12-217 of the general statutes is repealed and the following is substituted in lieu thereof (*Effective from passage and applicable to income years commencing on or after January 1, 2010*):

(3) Notwithstanding any provision of this section to the contrary, no dividend received from a real estate investment trust shall be deductible under

this section by the recipient unless the dividend is: (A) Deductible under Section 243 of the Internal Revenue Code; [or] (B) received by a qualified dividend recipient from a qualified real estate investment trust and, as of the last day of the period for which such dividend is paid, persons, not including the qualified dividend recipient or any person that is either a related person to, or an employee or director of, the qualified dividend recipient, have outstanding cash capital contributions to the qualified real estate investment trust that, in the aggregate, exceed five per cent of the fair market value of the aggregate real estate assets, valued as of the last day of the period for which such dividend is paid, then held by the qualified real estate investment trust; or (C) received from a captive real estate investment trust that is subject to the tax imposed under this chapter. For purposes of this section, a "related person" is as defined in subdivision (7) of subsection (a) of section 12-217m, "real estate assets" is as defined in Section 856 of the Internal Revenue Code, a "qualified dividend recipient" means a dividend recipient who has invested in a qualified real estate investment trust prior to April 1, 1997, and a "qualified real estate investment trust" means an entity that both was incorporated and had contributed to it a minimum of five hundred million dollars worth of real estate assets prior to April 1, 1997, and that elects to be a real estate investment trust under Section 856 of the Internal Revenue Code prior to April 1, 1998.